

## **Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions**

### **About MasterCard**

MasterCard is a payments technology company that enables cardholders, merchants and their banks to transact anytime, anywhere. MasterCard does not itself issue cards, set interest rates, extend credit lines or sign up merchants. Instead, we enable over 25 billion transactions a year globally as a result of our brands (MasterCard®, Maestro®, Cirrus® and PayPass™) and our network, as part of a 'four-party' payment system.

### **1. General overview – interchange regulation**

#### **The proposal**

On 24 July, the European Commission published proposals to regulate card payments across Europe by creating a new inflexible interchange rate. Interchange is a small price that a retailer and their bank pay to a card issuing institution (for example a bank or credit card company) each time a purchase is made using a card, to reflect the significant value that they receive from accepting card payments. It is a crucial balancing mechanism ensuring a fair apportioning of costs related to card transactions between merchants and consumers and IC fees therefore differ significantly as well, thus allowing for the flexibility necessary to ensure vibrant and innovative card payments.

Under the EC's proposals, interchange fees for debit and credit transactions in the European Economic Area will be capped at 0.2% and 0.3 % of the transaction value.

MasterCard supports the objectives behind the regulation, namely promoting greater competition; increasing choice and transparency for consumers; more innovation; and furthering payment security and customer trust. We agree with the UK Government's comment in its response to the Commission's Green Paper, 'Towards an integrated market in card, internet and mobile payments' that, "The strategic challenge... is how to place Europe at the cutting edge of payments development in order to support a digital economy". We are concerned, however, that the regulation would in many respects be a retrograde step and would actually impede Europe from meeting this challenge.

Fostering electronic payments is in the interest of all parties involved: consumers, merchants, governments and policy makers, banks and of course card schemes. However, it is our view that these proposals overlook the interests of consumers and small and medium-sized enterprises ('SMEs'). This flaw stems from a debate that, while several years in length, has been dominated by the views of a single group composed mostly of large merchants.

MasterCard believes that if regulation is adopted, it should be based on a rigorous assessment of its impact on all the stakeholders, including consumers and SMEs, rather than simply focusing on the inputs from large merchants and should be based on facts and empirical evidence, including evidence showing whether or not consumers and SMEs would benefit from such an intervention. As adoption of electronic payments by consumers and SMEs is essential to achieving the Commission's objectives, the regulation must ensure that it promotes such adoption. There is clear empirical evidence that a number of the proposed measures in the regulation will harm consumers and SMEs, thereby preventing the Commission's objectives from being achieved and actually harming efforts to place Europe at the forefront of electronic payments.

## 2. Regulation of interchange fees

*EC Proposal: interchange fees for consumer debit and consumer credit transactions in the EEA will be capped at 0.2% and 0.3% of the transaction value. These caps will enter into force in a staged approach:*

- *In the first stage, all cross-border transactions in the EEA Member States will have to comply with the caps. However, the caps would also apply to centrally acquired (domestic) transactions, i.e. when a merchant contracts with an acquirer established in another EEA Member State, that (central) acquirer will pay a maximum 0.2%/0.3% interchange fee (See section 3 below).*
- *In the second stage, 22 months later, all domestic transactions – including domestic transactions acquired by a domestic acquirer – would be capped at the same levels.*
- *Commercial card interchange fees are not subject to the cap (but are subject to the other provisions rest of the proposed Regulation).*
- *All forms of interchange fee setting would be covered, i.e. when set by the scheme, or set multilaterally by the banks, as well as set bilaterally by an issuer-acquirer pair.*

### **WHY THE PROPOSED MEASURE WOULD GO AGAINST THE COMMISSION'S OBJECTIVES**

- **Proposed levels**

Interchange caps of 0.2% and 0.3% are levels arbitrarily defined by the EC, without any sound methodology or data to support them and the clear evidence that they will adversely affect consumers, small businesses and others. In particular, 0.3% will have a severe impact on the provision of premium credit cards in the UK.

The Commission claims in Recital 19 that they are based on the Tourist Test / Merchant Indifference Test (MIT), which purportedly (and quite arbitrarily) uses the cost of cash to merchants as the benchmark. However the Commission has never published any data on the cost of cash to merchants, despite having studied the issue at least twice. The MIT is also not an appropriate methodology for setting the level of interchange fees – merchants receive numerous benefits from card payments that they do not receive from cash and therefore cash is not a proper comparator for cards.

In addition, an absolute cap on the interchange levels will remove any flexibility to adjust the interchange rates across different products and merchant categories to reflect the different levels of risks (e.g. fraud, cardholder default) associated with different products / merchant categories / transactions types (face to face vs. e-commerce transactions).

- **Commission Impact Assessment**

The European Commission has not published an SME impact assessment at individual Member State level, which would appear to add weight to the notion that flat limits of a maximum 0.2%/0.3% across Europe are to achieve 'harmonisation' purely for purposes of uniformity. Without properly and adequately understanding the possible consequences in each country and for the full range of stakeholders based on local market conditions, the 0.2%/0.3% construct is simply arbitrary.

- **Impact on the UK**

The UK will be particularly impacted by the proposals – not only is the UK the most mature payments country (comprising around 30% of card payments in the EU) but also the largest users of credit

cards (comprising circa 70% of credit card usage in the EU), the largest e-commerce industry and one of the strongest innovation economies.

A recent study by Europe Economics has examined the economic impact if this regulation is forced upon the UK by Brussels:

- Losses in card issuers' revenues of up to £2.4 billion
- As a result cardholder fees to rise by up to £11 for debit cards and £25 for credit cards
- Large retailer savings of up to £2.2 billion
- No evidence that these savings are passed on to the consumer in lower prices
- Even if retailers passed on savings from their Merchant Service Charge (MSC) reductions in full to consumers (which did not happen in Australia or Spain), prices would only fall by between £0.0003–£0.08 per transaction for debit cards and between £0.40–£0.59 per transaction for credit cards, while credit and debit card fees rise significantly

As a result of research in this area and the experience of other countries, many stakeholder groups across Europe, including in the UK, are opposed to/or have serious concerns regarding the Commission's regulatory proposals – these include consumer groups, financial inclusion and debt advice groups, SME representative groups, e-commerce bodies and those seeking to reduce the black economy.

When interchange fees are artificially reduced, as the Commission is proposing, consumers and businesses are harmed. Australian, Spanish and US experiences of interchange regulation show that consumers and small retailers are the most disadvantaged at the expense of large retailers: cards become more expensive for consumers without any meaningful reduction in retail prices; retailers no longer adequately compensate issuers for the benefits they receive; issuers have no choice but to increase prices and reduce services for consumers and/or reduce the benefits they generate for retailers.

#### **MASTERCARD ALTERNATIVE PROPOSAL**

The interchange rates proposed by the Commission are just too low for the UK (and many other countries). MasterCard supports a higher degree of harmonisation of interchange rates within the EU as a long term objective but we strongly believe that the best approach to achieving this is to allow the market to set the rates based on an assessment of all of the relevant factors, including the interests of consumers and merchants. This approach ensures that the maximum number of consumers and the maximum number of merchants choose to adopt electronic payments.

If it were deemed necessary to grant any regulatory authority in this area, that authority should reside with domestic regulators that are expert in local market conditions and can better determine whether regulation may be appropriate domestically and, if so, what regulation best suits those conditions. This would provide greater flexibility and allow Member States to account for local factors in their country. The differences in local market conditions are acknowledged by the UK Government in its response to the Green Paper as a potentially objectively justifiable reason for different interchange rates across Member States. Of course, any method of setting interchange rates must take into account the interests of consumers and SMEs, to avoid the distortions created by the MIT, which looks primarily to the large merchant side of the equation.

### **3. Central/cross-border acquiring**

*EC Proposal - the legislation sets caps for interchange fees for consumer debit and consumer credit transactions of 0.2% and 0.3% over two stages. In phase 1 all cross-border transactions in the EEA Member States will have to comply with the caps. However, the caps would also apply to centrally acquired (domestic) transactions – i.e. when a merchant contracts with an acquirer established in another EEA Member State, that (central) acquirer will pay a maximum 0.2%/0.3% interchange fee .*

#### **WHY THE PROPOSED MEASURE WOULD GO AGAINST THE COMMISSION'S OBJECTIVES**

The provision on central acquiring will distort competition between central and domestic acquirers. The Commission's draft Regulation proposes that acquirers who are centrally acquiring domestic transactions should benefit from lower interchange levels during phase 1, which is two years before domestic acquirers start benefiting from lower domestic interchange fees. This will place them at a competitive advantage compared to domestic acquirers, who are likely to find it harder to become cross-border acquirers and will therefore be competing for an ever-decreasing domestic market.

Large retailers will also be placed at a competitive advantage, as unlike SMEs they will be in a position to contract with an acquirer established in another EEA Member State (rather than a domestic acquirer). They will therefore benefit from the lower Merchant Service Charges (MSCs) two years before SMEs.

In addition, given the volume of card payments in the UK in comparison to other Member States, there are more central acquirers domiciled in the UK than any other Member State. It is therefore likely that the UK will see a proportionately greater number of large and medium-sized UK merchants move their acquiring services to central acquirers established outside of the UK than in other Member State. If this occurs, it will inevitably mean lower revenues and profits for UK central acquirers and a subsequent drop in associated revenue to the Exchequer.

#### **MASTERCARD ALTERNATIVE PROPOSAL**

We believe that there is no need for such an intervention with a view to "facilitating" central acquiring as the number of central acquirers has been growing year on year. Removing this definition of cross-border acquiring will not only allow more time for domestic acquirers to prepare but also benefit SMEs, most of whom currently use domestic acquirers.

In addition, if the EC proposed cap on domestic interchange fees is removed, thereby giving Member States the option to set domestic fees, the cap applicable to centrally acquired domestic transactions during phase 1 should also logically be removed in this instance, as this cap has a direct impact on the level of interchange applicable to domestic transactions.

### **4. Level-playing field**

*EC Proposal - The EC's legislation only covers four party schemes (MasterCard, Visa and mainly debit local schemes). Three party schemes 'that operate in a similar way to four party schemes' (such as Amex GNS) by providing licenses to issuers and acquirers are covered by the legislation and consequently are restricted to providing incentives to issuers that do not exceed the interchange cap. Pure three party schemes, such as Amex, Diner and PayPal, are actually out of the scope of this legislation.*

## **WHY THE PROPOSED MEASURE WOULD GO AGAINST THE COMMISSION'S OBJECTIVES**

The vast majority of the cards issued under those schemes are consumer cards – therefore the largest share of their activities will be captured by the interchange fee cap. In comparison, the largest share of Amex's business is its “pure” three party, or proprietary activities, which would not be subject to the interchange fee cap – and this despite the recognition by the EC in its Green Paper and in the proposed Regulation that Amex proprietary operates with “implicit interchange fee”.

As demonstrated by the experience in Australia, if the implicit interchange in pure three party schemes was not regulated to the same extent, this would likely result in an increase in the use of unregulated three party proprietary card schemes. Given that the three party schemes are generally more expensive to the merchant and the cardholder than four party card schemes, this would run directly contrary to the EC's stated objective.

In addition, digital wallets (such as PayPal), which compete with cards for online payments but also increasingly for payments at physical points of sale, should be included as part of the proposed legislation.

## **MASTERCARD ALTERNATIVE PROPOSAL**

The inclusion of American Express Global Network Services (GNS) in the regulation will ensure progress towards a level playing field, although it is also important that any payments made by Amex to banks defined under their rules as so-called Amex ‘agents’ are also considered as interchange and therefore subject to the cap. However, to achieve a true level playing field Amex three-party (proprietary) and other three-party card schemes (e.g. Diner's) must be included, as well as expanding the scope of the proposed Regulation to include other competing schemes such as digital wallet providers like PayPal. It is encouraging that the UK Government is currently proposing this for the UK domestic regulator.

In addition, in most cases, digital wallets operate as the merchant within the four-party scheme, and will therefore be provided by their acquirer with more transparency on the composition of the MSC (Article 9(2)). Digital wallets should be required to disclose this information to merchants that are paid through their services (the “sub-merchant”). More generally, digital wallets should be required to disclose to the sub-merchant the level of the fees that they pay to third parties for the funding of the wallet. For example, PayPal would have to disclose to a sub-merchant, with whom it has negotiated an MSC of, say, 3% of the transaction value, that it incurred funding costs of, for example, 0.8% if the wallet is funded by a Maestro card.

## **5. Commercial cards**

*EC Proposal - Commercial cards are exempt from the interchange cap but are subject to the rest of the provisions including changes to the Honour All Cards Rule (HACR), surcharging or co-badging.*

## **MASTERCARD POSITION**

We are supportive of the exclusion of commercial cards from the interchange cap as they are very important to the UK. Commercial Cards are a very different product compared to consumer cards, offering merchants, cardholders, and companies / governments providing them to their employees / civil servants specific and sophisticated services, which come at a higher cost to issuers. Unlike consumer cards, which compete with cash, commercial cards do not replace cash but traditional invoicing, which is a less efficient, less transparent, and more costly form means of payments. Commercial cards are also important in supporting small businesses as a vehicle for flexible short

term financing. Capping interchange fees for Commercial cards would make issuers reconsider their issuance.

## **6. Honour All Cards Rule (HACR)**

***EC Proposal** -The European Commission proposes that the ‘honour all products’ aspect of the Honour All Cards Rule (HACR) is disallowed, meaning that merchants cannot be required to accept two products just because they belong to the same brand and/or category (e.g. debit, credit, prepaid, commercial) – unless these two products are subject to the same regulated interchange.*

### **WHY THE PROPOSED MEASURE WOULD GO AGAINST THE COMMISSION’S OBJECTIVES**

The HACR is vital to any payment scheme, as it provides certainty to the consumer that any card with a scheme logo on it will be accepted wherever the consumer sees the same logo in a retailer. If a merchant elects to accept MasterCard-branded cards, the merchant has a number of options to choose from – they can choose only to accept, for example, Maestro cards but not MasterCard cards, or Debit MasterCard cards but not MasterCard cards.

The most obvious consequence of the relaxation under the legislation is that a merchant may decide to accept only consumer cards (which will be subject to an interchange fee cap), but not commercial cards (which will not be subject to an interchange fee cap). This would create uncertainty for consumers and delays and missed sales for retailers.

### **MASTERCARD ALTERNATIVE PROPOSAL**

The current proposed credit interchange rate of 0.3% will have a severe impact on the provision of premium credit cards in UK. We are of course aware of the UK Government’s concerns regarding the HAC rule, especially with regard to premium cards and are more than happy to discuss how this might be addressed given the specific concerns in the UK.

## **7. Separation of payment scheme and processing**

***EC Proposal** - The measure proposed by the European Commission would see separate entities required for payment card scheme and processing activities. The entities must be independent in terms of legal form, organisation and decision making, but the legislation stops short of explicitly calling for full ownership separation.*

### **WHY THE PROPOSED MEASURE WOULD GO AGAINST THE COMMISSION’S OBJECTIVES**

The measures are not addressed in the Commission’s accompanying Impact Assessment. This is because the Commission is trying to address a problem that does not exist. The Commission is apparently seeking to open up competition by preventing multinational schemes from bundling scheme and processing activities. However, MasterCard is already compliant with the SEPA Cards Framework and therefore does not bundle payment scheme and processing services. MasterCard’s customers are free to issue a MasterCard branded card / acquire a MasterCard transaction without relying upon MasterCard’s processing services. This is evidenced by the fact that, in Europe, MasterCard only processes a minority of the transactions undertaken under one of our brands.

Forcing a legal separation of the payment scheme and the processing functions is an entirely disproportionate measure. Card schemes and processing activities are not vertically related like utilities but instead are parallel activities. There is no dependency by third parties on a monopolistic network.

## **MASTERCARD ALTERNATIVE PROPOSAL**

MasterCard agrees with the UK Government's view that this proposal is unnecessary, disproportionate and excessive and seeks to solve a problem that does not exist while introducing a greater degree of unnecessary requirements and costs for payment schemes and ultimately merchants and consumers. Instead, we propose that Article 7 is amended to reflect what is currently required by the SCF, so that the essential existing requirements of the SCF would become legally binding on the schemes, and subject to the supervision of the "competition authorities" that are provided for in the proposed Regulation.

### **8. Co-badging**

***EC Proposal** - The European Commission proposes that payment networks cannot prohibit issuers from putting a competing brand on their debit and credit cards. Cardholders will theoretically choose which brand to use at the point of sale. Also, it proposes that a payment network cannot impose reporting requirements or fees for transactions carried out under another brand present on the card.*

### **WHY THE PROPOSED MEASURE WOULD GO AGAINST THE COMMISSION'S OBJECTIVES**

Co-badging, under the right conditions, can bring benefits to cardholders and merchants, such as the apposition of the Maestro logo on a domestic scheme card, which enables consumers to use their domestic payment scheme card abroad. However, issuers can and do already co-badge and it should remain up to the brand owner to allow this to occur, especially if being placed with a global competitor.

Any brand / scheme should have the right to protect its brand and products to avoid affiliation with payment card schemes that may compromise its brand reputation and/or may cause technical interoperability issues. In addition, arbitrarily allowing co-branding by issuers without any right for the scheme to control how its brand is being used risks leading to unnecessary complications, such as creating a confusing experience for both consumers and merchants at point of sale and greater complexity and lower reliability of the system as a whole. It should be the consumer that chooses which scheme brand to use, in order that they may determine which brand provides the best value proposition. Of course, it is always up to the merchant to decide which brands to accept.

As regards the prohibition for a scheme to impose a fee and/or reporting requirements to its customers on transactions that are performed under another application on the same co-badged card, if the scheme and the customers contractually agree that the transactions done under a competing brand on the card should be used as a basis for determining the fees payable to the scheme, there their contractual freedom should be respected and this practice should therefore not be disallowed.

## **MASTERCARD ALTERNATIVE PROPOSAL**

MasterCard agrees with the UK Government's view that this provision is unnecessary, highly impractical for consumers and very unlikely to provide any consumer benefit and therefore suggest that Article 8 be deleted entirely. Co-badging is especially damaging to consumers where merchants make the choice as to which brand on the card will be used in a given transaction. Payment card schemes and their customers (i.e. issuers and acquirers) should be free to continue to agree on the financial terms applicable to co-badged cards.

**9. Access provisions for 3-party networks (proposed Article 29 of PSD II)**

*EC Proposal - Under the current Payment Services Directive (PSD) I, Article 28 (Access provisions) requires four party schemes to grant issuing and/or acquiring licenses under objective, non-discriminatory and proportionate conditions. Article 29 of the draft PSD II would extend this requirement to three party schemes.*

**MASTERCARD POSITION**

MasterCard is in favour of such a measure because it goes towards the creation a level playing field and will help the domestic payments regulator achieve this – any issuer or acquirer wanting to issue Amex/Diners cards or acquire Amex/Diners transactions would have to be granted a license and any transactions on these cards would be subject to the regulated interchange fee cap. This may benefit merchants since it may open the competition on acquiring of Amex/Diners transactions, which in turn may lead ultimately to lower costs for merchants, assuming that Amex does not charge an acquiring license fee that is artificially inflated so as to prevent such competition from arising.